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141120Z Oct 05

UNCLAS SECTION 01 OF 03 PRETORIA 004181

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DEPT FOR AF/S/MTABLER-STONE; AF/EPS; EB/IFD/OMA
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E.O. 12958: N/A
TAGS: ECON EINV EFIN ETRD BEXP KTDB PGOV SF
SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER
October 14 2005 ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Interest Rates Remain Unchanged;
- August Manufacturing Production Rebounds;
- Consumer Confidence Still Strong;
- Cabinet Approves Plan for 6% Growth by 2010;
- Stats SA Plans to Revise Labor Force Survey; and
- Report Highlights Poverty among Black Youth.

End Summary.

INTEREST RATES REMAIN UNCHANGED

¶2. Citing high oil prices, deteriorating inflationary expectations, and higher global inflation as increasing risks in meeting the 3-6% inflation target, the South African Reserve Bank (SARB) decided to leave interest rates unchanged at the October 12-13 Monetary Policy Committee (MPC) meeting. A 1.3 percentage point increase in CPIX (consumer prices minus mortgage costs) since the last MPC meeting in August signaled increasing risks of inflation overshooting the 6% ceiling. Although the impact of substantially higher fuel costs have not yet translated into higher prices in other goods and services, the SARB felt that higher oil prices in the future would pose a significant inflation risk. August CPIX increased 4.8%; while if fuel costs were excluded, CPIX increased by only 3.6 percent. The SARB also cited the latest inflations expectations survey by the Bureau of Economic Research that indicates inflationary expectations increased 0.3% and 0.4% in 2006 and 2007, respectively, with CPIX inflation expected to reach 5.2% in 2006 and 5.4% in 2007. The SARB views that the deterioration in the inflation outlook cannot be ignored, so the repurchase rate remains at 7% and prime lending rates are at 10.5%. The SARB still expects inflation to remain below the ceiling, with peak inflation occurring during the first two quarters in 2006, at a level just below 6%. The market consensus expected SARB would not change interest rates during the October MPC meeting. Source: IOL; Statement of the Monetary Policy Committee; MPC Alert Standard Bank, October 13.

¶3. Comment. South African real interest rate is 3.1% (the repurchase rate minus CPI inflation), while the current U.S. real interest rate is 0.15% (federal funds rate at 3.75 and US CPI inflation at 3.6%). Expectations are that the U.S. will continue to increase interest rates in November. End Comment.

AUGUST MANUFACTURING PRODUCTION REBOUNDS

¶4. August manufacturing production grew by 3.5%, up from July's growth of 2.6%, due to strong consumer demand and a weaker rand. The domestic consumer now buys 80% of manufacturing output, and boosted growth in the manufacturing sector throughout 2004 when South Africa's main trading partner, the European Union experienced slower growth and South Africa's rand strengthened 17%. So far in 2005, the rand has depreciated 14% against the dollar, leading to lower prices of manufactured exports. On a quarterly basis, seven out of the 10 manufacturing sectors reported higher growth ending in July 2005. Quarterly manufacturing production increased by 1.2% (seasonally adjusted), explained primarily by growth in the furniture, motor vehicle, and petroleum sectors. The motor vehicles sector contributed 0.8 percentage points to the increase in total manufacturing production; petroleum, chemical products, rubber and plastic products accounted for 0.5 percentage points; furniture explained 0.5 percentage points. However, production decreases were reported in the basic iron and steel, non-ferrous metal

products, metal products and machinery division (1.2 percentage points) and the textiles, clothing, leather and footwear division (0.2 percentage points). Source: Standard Bank, Manufacturing Unpacked, October 12; Business Day and Business Report, October 13.

¶5. Comment. Recent leading indicators of manufacturing activity, such as the Bureau of Economic Research's Purchasing Managers' Index, has been trending lower in the recent months from a peak of 60 in July to 55.7 in September. The number is still above the critical value of 50, which indicates that the sector should still grow in the months ahead. The manufacturing data just published is the last statistical release based on the sample drawn from the new business register in 2004. Data for September will be based on a new sample of manufacturing enterprises, which was drawn in August 2005 and will take account of the latest developments in South Africa's manufacturing sector. End comment.

CONSUMER CONFIDENCE STILL STRONG

¶6. Consumer confidence during the third quarter 2005 remained unchanged from the previous quarter, reaching 17 points, according to the First National Bank (FNB) and the Bureau of Economic Research. This level is close to the highest level recorded during the second quarter of 2004 when it reached 20. Consumer spending is expected to remain strong for the next year or so, although higher fuel prices could erode household purchasing power to some extent, according to FNB Chief Economist Cees Bruggemans. Low interest rates, consecutive personal tax rate cuts and stable prices of durable and semi-durable goods have strengthened consumers' ability to spend. Rising oil prices have been the main reason for the rise in CPIX (consumer price index less mortgage costs) although so far only transport costs are affected. In August, CPIX, the targeted measure of inflation, rose to 4.8% and is expected to peak at around 5.5% in the first quarter of
¶2006. From June to August, when the third quarter confidence index survey was conducted, the petrol price increased 54 rand cents/liter. Although higher transport costs and slowing house prices could slow consumers' confidence in next quarter, these were offset by low food prices, and a pick-up in employment on the back of higher economic growth. Source: Business Day, October 13.

¶7. Comment. The range of consumer confidence index has been from minus 36 to plus 20 over the past 30 years. The average of the last three months has been at the top of the range. End comment.

CABINET APPROVES PLAN FOR 6% GROWTH BY 2010

¶8. Cabinet approved a report from Deputy President Phumzile Mlambo-Ngcuka's Economic Growth Task Team, describing South Africa's plans to achieve accelerated growth. Short on detail, the report forecasted a GDP growth rate of 4.5% in the immediate term, projected to rise to 6% between 2010 and 2014. The National Treasury projected growth at 4.3% in 2005, although this could be revised upwards when Finance Minister Trevor Manuel delivers his medium-term budget in November. The South African Reserve Bank and independent economists have said a 4.5% GDP growth rate was feasible in the short term. Government spokesman and Advisor to the President Joel Netshitenzhe cautioned that 6% growth would only be achieved in the medium-to-long term. Challenges including infrastructure development, sector investment strategies, education and skills development, second economy interventions and improving the capacity of the state to provide economic services had to be addressed. The private sector would be expected to intensify investment in job-creating sectors. Government would also try to reform labor markets. Cabinet also agreed to phase out import parity pricing and to introduce nondiscriminatory pricing in some sectors. High input costs are identified as one of South Africa's growth blockages, and Netshitenzhe said "further work" would be done to lower the costs of doing business. Cabinet also recommended focusing government procurement of goods and services to small businesses. Source: Business Day October 13.

STATS SA PLANS TO REVISE LABOR FORCE SURVEY

¶9. Statistics SA (Stats SA) will introduce a revised model of its labor force survey around 2008, responding to recent criticisms by the International Monetary Fund (IMF). There has been intense debate about the accuracy of South Africa's unemployment statistics, which range from the official rate of 26% to the broader measure of 41%, depending on the definition of unemployed. Those in favor of a restricted definition, based on those actively seeking work, argue that being without formal-sector employment does not necessarily mean people are without

any form of work or income. Those in favor of an expanded definition of unemployment argue that to exclude the many discouraged job-seekers who have given up hope of finding a job does not give an accurate picture of the extent of unemployment in the country. The IMF pointed out certain weaknesses in methodology that could lead to inaccuracies in the measurement of employment and unemployment, according to Stats SA's Deputy Director-General of Statistical Support, Liz Gavin. One of the aims of redesigning the labor market survey would be to differentiate more precisely between types of jobseekers. Source: Business Day, October 12.

REPORT HIGHLIGHTS POVERTY AMONG BLACK YOUTH

¶10. A new report by the Human Sciences Research Council highlights the difficulties in escaping poverty by black South Africans aged 18 to 35. More than two-thirds of black South Africans in this age group are unemployed and more than two-thirds of young people who took part in the survey had never had the opportunity to work. There was a correlation between education and employment, 33% of those with secondary and 5.1% of those with tertiary qualifications were unemployed. Almost half of the black youths who were not studying did not have the financial means to continue their studies. The average number of years taken to finish school was 60% higher than the standard 12 years because many pupils were forced to repeat grades or drop out of school. The report found that personal contacts and networks remained a determining factor in youth finding first employment. A third said they found their first job through personal contacts, and just 15% got a job through sending out their details. Source: Business Day, October 12.

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